Canada's
Mining
Industry —

Where do we go from here?

Remarks by Alfred Powis
to the Canadian Club,
Toronto, February 3, 1975

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Mr. Chairman, Ladies and Gentlemen:

It's a great honour to have been invited to speak to you today. I won't say it's a great pleasure — as your Chairman knows, I approach this sort of assignment with something approaching abject terror, and the fact that I'm standing up here today is a tribute to his powers of persuasion.

This talk had its origins last November when Jerry McAfee spoke so effectively to this Club on the status of the petroleum industry. Your Chairman felt that someone should do a similar job on mining, and since we both belong to the same investment club I was elected. (Perhaps this is his way of getting back at me for the contribution Noranda stock has made to the Club's dismal recent investment performance.) In any event, in the hope that some of Jerry's success might rub off on me, I've taken his title of last November — with, of course, mining substituted for petroleum.

Mining and Petroleum

The real reason I finally agreed to give this talk is that the serious plight of the mining industry has been obscured by the excitement and controversy surrounding petroleum. Our attention is focused on the energy crisis, since it's easy for people to understand the implications of a shortage of gas for their cars or heating oil for their houses. Mine products are taken for granted, although modern society couldn't exist without them, and the industry's operations take place in regions remote from the large centres of Canadian population. Thus, with so many other problems clamouring for

public attention, it's not surprising that the problems of mining are only dimly understood by most Canadians.

There are superficial similarities between the mining and petroleum industries, in that each extracts so-called non-renewable resources which are discovered as the result of high-risk exploration. Nevertheless, there are profound differences between the two, and the tendency to lump them together is one of the curses of mining.

One of the differences, of course, is that mine products unlike petroleum are generally not consumed, merely transformed. Once a gallon of gas is burned in your car it's gone forever, but most of the copper mined throughout mankind's history is still available. In fact, a significant portion of the annual supply of most mine products is from recycled material.

There are a great many other differences, but two of them are central to the problems faced by mining today. The first is that the lifting cost of a barrel of oil is a small percentage of its wellhead value, while the cost of mining and concentrating is generally a high percentage of the value of a ton of ore. The second is that there is no effective cartel controlling the supply and price of mine products, nor is there any prospect of permanent shortages. The demand for, and prices of, mine products have always been cyclical and remain so. Thus, policies deemed appropriate for petroleum may prove disastrous if they're also applied to mining.

These differences may seem obvious, but they don't seem to be understood by most Canadians, including those who establish tax policy. For example, the Treasurer of Ontario in last April's budget made the following statement. "During the past two years a worldwide shortage of raw materials has developed on an unprecedented scale. Increased demand by major industrialized countries has resulted in sharply higher metals prices and substantial windfall gains for the mining industry in Ontario. With the prospective demand for minerals likely to sustain current price trends into the future, it is only fair that we secure for the people a higher return from our natural resources."

The fallacy of this is indicated by the fact that last April, when this statement was made, the price of copper in world markets reached over $1.50 per pound while recently it has been less than 55¢. In pointing this out, I'm not trying to ridicule the Treasurer's abilities as a metals price forecaster — those of us who are supposed to be experts in this area have dreadful records too. But we can never lose sight of the fact that we deal in highly cyclical and volatile commodities, and public policies which fail to take this into account will prove to be ruinous for the industry.

Following last May's aborted budget, a federal government official remarked that the mining industry had been run over by a truck headed for Peter Lougheed. However, for petroleum there's an apparent solution to the problem of conflicting federal, provincial and industry demands — which is to increase the size of the pie by raising the Canadian price of crude oil. This solution is simply not available to the mining industry. And when we hear optimistic talk about possible solutions to resource taxation problems — as we did last week from the Minister of Finance — we're really hearing about oil. For mining, there seems to be no light at the end of the tunnel.

In an attempt to call attention to these problems, the Mining Association last summer published a newspaper advertisement with the headline "Does Anybody Out There Give a Damn if the Mining Industry is Taxed to Death". The reaction in certain quarters was predictable. Various critics rushed to print with caustic comments contrasting record reported earnings with the industry's cries of doom. Government reaction seemed to be that the industry was overreacting and exaggerating. Let me assure you we were not. Rather, the advertisement in question represented a fustrated and anguished, but nevertheless accurate, appraisal of the situation as we see it.

I want to return later to the problems of taxation, but perhaps it would be appropriate first to say a few words about the industry's position in the Canadian economy.

The Importance of Mining to Canada

It seems necessary to stress this because the importance of mining to Canada has been obscured by our preoccupation with energy problems. Today, nobody needs to be reminded of the critical importance of our petroleum industry in spite of the fact that public policy toward it has, at best, been somewhat perverse. The fact is that mining is of equal importance to this country.

Today, Canada is the world's third largest producer of mine products, ranking after the United States and Russia. The industry accounts for about the same proportion of our gross national product as oil and gas — something over 4% — and a further 8% of our GNP is dependent on its activities due to its heavy expenditures for goods and services. It directly employs some 3% of our labour force, but because of its linkages with other sectors of the economy it provides the basis for employment of a further 12% of our working population. About 80% of its output is exported, providing about a quarter of Canada's total export earnings.

Moreover, the contribution of mining to the Canadian economy in the post-war period has been dynamic. Since the 1940's its share of the GNP has increased during a period when the relative share of the goods-producing sector has declined due to the growth of the government and service sectors. It now accounts for over 10% of the goods-producing sector of our economy.

There are, in addition, important qualitative contributions made by mining to our economy. It has made a unique and pervasive contribution to the settlement and development of Canada outside the normal industrial areas. Real output per employee is about three times that for the economy as a whole, and it's one of the few sectors where productivity exceeds that of the United States. As a result, while employee earnings in mining are well above the national average, the industry is internationally competitive, without any need for subsidies or protection. Canadian expertise and technology in mining and related fields is internationally

respected and widely sought-after, and this is a national asset equally as important as our mineral endowment. And, despite the image, this has been achieved by an industry which is over 50% Canadian-owned and overwhelmingly Canadian-managed.

This record has been accomplished in the context of a mineral endowment which, while extensive and diversified, is not uniquely large or rich. In fact, our share of world mine production is greater than our share of proven reserves or geological potential. The main reason for the rapid growth of mining is simply that Canada has benefited from a substantial share of the world's exploration and development effort. We received a favourable share of exploration activity because of the existence of a strong industry in this country and a hospitable political climate toward mining. In turn, this led to more rapid development of new discoveries than has been the case in many other parts of the world, where much higher rates of return have traditionally been required on new mine projects. For example, average annual earnings on U.S. investments in mining in Canada returned less than 10% from 1954-67 compared with 25% in Latin America.

Basic Problems

So much for where we've come from and where we are today. To deal with the question "Where do we go from here?" it's necessary to come to grips with the various problems faced by the industry. There are a number of them, many of which are not unique either to the industry or to Canada. They include such things as labour shortages, unstable international trade and currency relationships, economic recession or worse, widely fluctuating prices for our products, and so forth.

There are, however, two interrelated fundamental problems which affect mining in a particularly debilitating way — inflation, and the public and political perceptions of the industry.

The Problem of Inflation

Inflation creates a number of serious problems for mining, as it does for any industry. The most serious stems from the fact that mining is capital intensive, and the cost of new construction and equipment has been escalating at a rate which bears no relationship — at least not yet — to the increase in the Consumer Price Index. Our best estimate is that the cost of developing a new mine in February, 1975 dollars is more than double what it was three years ago and five times what it was ten years ago. Moreover, if we started a new project today with a multi-year construction period, our estimate of its ultimate cost would only be a guess and, based on recent experience, probably a bad one at that.

This, of course, makes preparation of the credible feasibility study required to attract the capital needed to develop a new orebody almost impossible. When this is combined with the destructive effect of inflation on capital markets, the impact on the industry's ability to finance new mine projects becomes extremely serious.

A related problem is the fact that financial statements prepared in the traditional way become meaningless in this sort of environment. Assets are carried at historical costs while earnings are stated in current dollars, and the two are simply not the same thing. It would make just as much sense to state assets in pounds sterling and earnings in Japanese yen. A corporation or industry may appear to be earning a lucrative rate of return on assets carried at historical values, but the level of prices for its products may still be inadequate to justify new capacity at present construction costs. Clearly, inflation requires us to adopt new accounting methods to avoid misleading not only our shareholders and employees but also the public at large.

In the meanwhile, we've all been subjected to a barrage of political propaganda regarding enormous increases in corporate profits, characterized as a "rip-off" which is the major cause of rising consumer prices. It's tempting to adopt a cynical attitude toward such rhetoric, but unfortunately it's believed by a substantial number of Canadians.

One group which doesn't believe it of course is the investors, against whom the real rip-off is being perpetrated, and this creates another set of problems. Moreover, the fact that most of us are not going to be faced with criticism of enormous profit increases in 1975 is pretty cold comfort.

Despite appearances, the simple truth is that 1974 prices for most mine products were not adequate to justify new capacity at today's construction costs. In fact, there are numerous examples of successful existing operations which could not be economically developed under recent conditions. Besides, with capital markets in disarray, new developments must be financed more than ever before from profits, and 1974 profit levels were simply inadequate to do this.

The Problem of Public and Political Perceptions

This leads to the second basic problem of mining, the adverse public and political perceptions of the industry. At the root of this is the repeated assertion that the industry earns excessive profits — called economic rents — from the extraction of non-renewable resources belonging to the people, and that an inadequate proportion of these profits is returned to the people in the form of taxes. The fact that this perception bears no resemblance to reality makes no difference. It has become part of Canadian conventional wisdom.

What appeared at the time to be an extreme example of this point of view was a report prepared two years ago for the government of Manitoba. After dealing at great length with the so-called super profits of the industry, this report recommended that existing mines in effect be confiscated without compensation through use of the tax system. For the future, it proposed that all exploration be conducted by the state and that all new mines so discovered be developed by crown corporations. While these recommendations were repudiated by the province, subsequent events indicate that their underlying philosophy has had an insidious impact on public policy throughout Canada.

The result has been a complete reversal of past Canadian policies, which worked so well, of incentives for the exploration and development of new mines. The federal tax reform legislation, which eliminated most of these incentives in the name of so-called equity, was serious enough. But over the past year, the industry has come to be regarded as a source of government revenues to be squeezed dry regardless of the long term consequences. In the process, it has been caught in the middle of a federal-provincial war over taxing powers.

In quick succession, British Columbia imposed a gross royalty on production and a "super royalty" on price increases. Saskatchewan came up with a tax on ore reserves in the ground. Manitoba substantially increased conventional mining taxes pending a new, and presumably more onerous, system. Ontario and Quebec weighed in with savage new graduated taxes. And the federal government, concerned that this bewildering array of measures was unreasonably eroding its corporation tax base, proceeded to disallow them as expenses in calculating income taxes. While I have considerable sympathy for the federal government's position, this was a final and devastating blow.

The end result of these rapacious and uncoordinated tax changes, is an abrupt and profound change in the industry's circumstances. Along with oil and gas, mining has become the most heavily taxed sector of the Canadian economy. Taking Noranda as an example, our average effective rate of tax on mining operations in 1973 was around 40% including federal and provincial levies. This, I should point out, is about the same level presently deemed to be appropriate for manufacturing and processing. In 1975, our effective rate of tax will vary from around 60% in Ontario and Quebec to more than 100% in some parts of Western Canada. Only in the Maritimes and the Territories does the tax rate remain, so far at least, at tolerable levels.

Does Mining Earn Economic Rent?

Of course, if the mining industry does earn an economic rent — which has been defined as a return beyond the level

needed for a producer to continue and expand its production — then a case can be made for some increase in taxes, although not to the preposterous levels now in place in much of Canada. In fact, it's the assumption that such economic rents exist that underlies many of the recent taxation changes.

Due to the long odds against exploration success, high capital intensity, fluctuating and uncertain markets, technical and environmental problems and so forth, mining is an industry involving greater than normal business risks. For this reason, virtually all studies of the tax system have concluded that mining requires a substantially higher rate of return than most other businesses. Among others, this conclusion was reached by the report of the Carter Commission, the White Paper on Tax Reform and a recent study by the World Bank. It was even stated by the leader of the N.D.P. during the recent federal election campaign, which certainly constituted support from an unexpected source.

In assessing the returns earned by mining, it's misleading to look at one year in isolation due to the cyclical nature of the industry. Viewed over a complete cycle, Statistics Canada data indicate that from 1969-73 the mining industry's rate of return on capital employed fluctuated between 3.6% and 10.2% and averaged 7.6%. In the same period, the rate of return in manufacturing fluctuated between 5% and 10% and averaged 7.1%. Thus, mining's ostensible rate of return has been more volatile, but on average not much better, than that of manufacturing. And because of the impact of inflation on capital intensive industries such as mining, the small gap which appeared to exist was an illusion. Moreover, these returns were earned under a tax system which has since been profoundly altered — to the detriment of mining and to the benefit of manufacturing.

If this is true, how does this image of economic rent or super profits arise? The answer seems to be twofold. There are, of course, individual examples of economic rent in mining resulting from deposits which are unusually rich and large. Such bonanzas, while spectacular, are rare but it's the

hope of earning an economic rent through discovery of one of them which keeps most of us in the high-risk exploration business. However, there seems to be a tendency to generalize from the particular, and to assume that such bonanzas are typical. If no individual producer is to be permitted an economic rent, then the most important incentive to exploration is destroyed. Besides, a tax system designed to confiscate the economic rents earned by a few producers results in serious overtaxation of the industry in aggregate.

Aside from the problem of generalizing from particular circumstances, the tax systems now in place seem to assume that the industry's favourable economic circumstances in 1973 and early 1974 were permanent. They aren't, as will be painfully demonstrated in 1975. In fact, a recent article in The Economist forecast that the terms of trade for most raw materials will be below early 1974 levels through most of the next 20 years.

Where Do We Go from Here?

In any event, what we now have in place is an array of tax structures in much of Canada which make it impossible for the private sector to earn a reasonable return on most new mine development. When combined with the problems of inflation referred to earlier, this creates an outlook for mining which is profoundly discouraging. If new mines can't be profitably developed, there's no point in looking for them and the declining trend in exploration of the past few years will accelerate. Investment by the industry in new projects has also been declining, despite the image of prosperity, and this will continue.

The future level of activity in mining is, of course, a function of success in finding new orebodies which, in turn, depends on the level of exploration activity. Lead times in the industry are long, and over the recent past we have continued to benefit from the momentum built up in the 1960's. For the same reason, today's problems will not have an obvious impact for several years. In the period ahead, how-

ever, stagnation and decline in the industry are inevitable unless the rules are changed.

It must be added here that, even if we were to revert tomorrow to the tax rates of the 1960's, confidence in the stability of the system has been shattered and won't be quickly rebuilt. This means that a new perceived risk has been added to the many others inherent in mining, increasing the rate of return required on new ventures. When this factor is added to the problems of inflation, the result is that many new operations started over the past decade would not be considered economically viable for development today, even under a reasonable tax system. In other words, we've reversed the old alchemist's dream by converting ore into waste rock.

Noranda's situation may be fairly typical of what is happening. Looking at 1975, we found ourselves facing a sort of bad news/good news situation. The bad news was that in the face of declining cash flow, the inadequacy of depreciation charges to cover needed replacements and the depressed state of the capital markets, we found it necessary to eliminate $100 million from the capital spending previously planned for 1975. The good news was that, with the impact of taxes and inflation on the economics of new development, we had little difficulty in finding projects which were worthy candidates for elimination.

Why Are We In This Mess?

Why are we in this mess? In the minds of some, a decline in the mining industry would be a good thing. It's argued that past national policies designed to stimulate investment have fostered capital intensive primary industries such as mining at the expense of other sectors of the economy. It's alleged that such industries have paid very little in taxes, have created little new employment, have exported most of their production in raw form, and have contributed to foreign domination of our economy. The conclusion is that we need an industrial strategy which will divert capital from primary industry to the secondary manufacturing and service sectors, where many more jobs will be created per unit of investment.

Of course, this is utter nonsense. It ignores the international character of mining capital, the real employment effects of the industry, and the fact that capital intensive industries are most likely to be the ones which can provide the quality of employment and level of incomes Canadians demand. It misstates the extent of further processing, the level of taxation and the extent of foreign ownership. It relies on Canadian conventional wisdom that a role as a producer of basic raw materials is a source of weakness, while recent events have demonstrated that instead it is a source of strength. And it fails to come to grips with what other viable industries we can create to take mining's place. And yet this point of view has undeniably had an impact on Canadian public policy.

In this connection, the Chairman of the Economic Council recently argued that employment creation should not be the major objective of national policy, since population growth in Canada will be slowing down in future and our basic problem will become a shortage of labour. He pointed out that the relentless tendency of manufacturing industries to locate in southern Ontario creates problems in terms of national unity and massive metropolitan concentration. He suggested that we should stop trying to do everything and specialize in fields where we have a comparative advantage. He forecast that we will see a renewed emphasis on primary industry in future, accompanied by accelerated development of those regions outside our existing major urban agglomerations. If he is right, and I think he is, our present national policies are clearly perverse.

Mining's problems also stem from a lack of understanding of the industry combined with our lack of credibility. Some governments in Canada don't wish to damage the industry but simply won't believe us when we say they are doing just that. It seems that credibility will only be established when the expected stagnation becomes obvious to all, but this will be a long and painful process. And by the time it happens, our momentum will have been lost and will be extremely difficult to regain.

A third source of our problems is doctrinaire. There are many who simply believe that mines should be operated entirely by the state, and to them no doubt the universe is unfolding as it should. In a remarkable turnaround one of the industry's most vocal critics, who only a few months ago was attacking the excessive level of mining profits, was quoted recently as saying that the combined federal and provincial tax moves had left no room for the private sector in mining.

If governments could effectively and efficiently step into the role previously played by the private sector in mining, presumably only the shareholders will care if investor-owned corporations are displaced. However, while minerals may belong to the people, they must be found and developed before they become assets, which requires a great deal of skill and high-risk capital. Canadians should not accept uncritically the assumption that our governments can effectively replace the private sector in this activity. If they were really able to pull this off, it would be an achievement without precedent in the western world. This is not meant to denigrate politicians and civil servants. It's simply that the functions are different, and they're no better equipped to find and develop mines than I am to run the government.

So the answer to the question, "Where do we go from here?" is "Nowhere". The industry's mood is one of frustration and despair. What we face is a significant decline in the level of mining's contribution to the Canadian economy. Present circumstances won't force the shutdown of many existing operations, but few new projects which aren't government sponsored or artificially induced will be undertaken in most of Canada in the future. The level of exploration will be inadequate to replace, much less enlarge, the reserves being extracted. Nor can this stagnation and decline be readily reversed.

Mining makes an irreplacable contribution to Canada in terms of our living standards, regional development and balance of payments. It's highly productive and inter-

nationally competitive. The erosion of the vitality of an industry in which Canada has been a world leader, for the sake of a transitory increase in tax revenues, is a national tragedy.

Conclusions

While the mining industry's problems are serious enough in themselves, in my mind they raise a number of questions of a very much more fundamental nature:

— Except in terms of degree, are the problems of public and political perceptions referred to earlier unique to the resource industries?

— Are the problems which compelled curtailment of our 1975 capital program unique to Noranda or, for that matter, to the resource industries?

— With profits in disrepute and investor confidence shattered, how can the private sector finance the very large expenditures needed in the years ahead?

— In fact, does it make any sense for corporations to embark on risky new projects when comparable assets are selling at a fraction of replacement cost on the stock markets?

— Under the conditions we face in Canada today, will the private sector be able to do the job expected of it in the years ahead?

— If the private sector is to be crippled, what is going to take its place and is this really what Canadians want?

— If the vitality of our economic institutions is being eroded, are our social and political institutions secure?

In the short run, business capital spending is supposed to be the main source of strength in the Canadian economy in 1975. If Noranda's current experience is being widely duplicated, this is going to be a year most of us will wish never happened. About the only benefit which could flow

from this might be a renewed public appreciation of the value of profits.

Looking further ahead, I believe that the current problems of the resource industries are really manifestations of an attack on the private sector as a whole. And in the process, its vitality is steadily and insidiously being sapped. At a time when we should be strengthening our industries to withstand the increasingly difficult external conditions which face us, we're preoccupied with internal squabbles. The private sector is increasingly subject to uninformed, but strident and widely publicized, attacks which seem to have a pervasive impact on government policies. And few people outside the private sector (which is not notably articulate) seem prepared to defend a system which, for all its faults, has given Canadians one of the world's best living standards in terms of both quantity and quality.

The economic system under which we operate is as strong and flexible as anything yet devised, but there's a limit to the amount of abuse it can absorb and non-productive acitivity it can support. That limit may well have been passed.

We're moving into a very different world than the one to which we've all become accustomed. Canada's position is relatively strong, but we don't seem to understand the reasons for our success. More than most countries, we have the opportunity to weather this period without extremely serious and painful consequences, if we can only build on our strengths and minimize our weaknesses. If we can find a better way for the various sectors of society and levels of government to work together, we'll succeed.

If we don't, we'll blow it.

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Report of the Annual Meeting

April 25, 1975

ANNUAL MEETING REPORT

This brief report has been prepared for the benefit of shareholders who were unable to attend the Annual Meeting.

The meeting was convened at 2:30 p.m. at the Royal York Hotel, Toronto with about 400 in attendance. Alfred Powis, President of the Company acted as Chairman. There were 16,216,452 shares or 66.8% of the total shares represented either in person or by proxy.

Tribute was paid to John D. Simpson, Chairman of the Board of Placer Development, who has been a Director of Noranda since 1962. Mr. Simpson did not stand for re-election and was appointed an Honorary Director. The President also honoured Mr. R. V. Porritt, who retired as a Director in December, 1974 after a distinguished career with the Company which began in 1926 at the Horne Mine. Mr. Porritt had been a Director of the Company since 1958. He was also elected an Honorary Director of the Company.

The Annual Report, including the Auditor's Report, was submitted to the meeting.

The following shareholders, who were present, were elected Directors of the Company: James C. Dudley, Louis Hebert, William James, A. J. Little, L. G. Lumbers, T. H. McClelland, D. E. Mitchell, Andre Monast, Alfred Powis, W. S. Row, W. P. Wilder and A. H. Zimmerman.

Clarkson, Gordon & Co., Chartered Accountants, were reappointed auditors.

Following completion of the formalities of the Meeting, questions were invited from the floor and were answered as follows:

In response to a question as to whether Noranda had considered appointing a woman director, Mr. Powis answered that it would be 'tokenism' to appoint a woman

to the Board simply on a basis of female representation. The Corporation sought the best possible expertise from outside the corporation to bring to bear on its efficient operation and as yet had not come upon someone whose expertise in the Corporation's various fields was such that it made her an obvious choice as a Director.

A shareholder complimented the Company on the excellence of its 1974 Annual Report.

NORANDA MINES LIMITED

Address of the President
To the Shareholders at the Annual Meeting

Ladies and Gentlemen:

Superficially, 1974 seemed to be an excellent year for Noranda. Despite weakness during the second half, average prices for most products were substantially higher than the previous year. Volume also increased compared with 1973, as the impact of strikes and operating problems on the level of production was moderated. These factors more than offset the alarming rise in costs and taxes, and earnings increased by 27% to a record $6.59 per share.

The nine-year summary in the Annual Report helps put these results in perspective. In 1974, earnings rose to 2.7 times those of 1966, but only because capital employed almost quadrupled. During the period many substantial new projects were undertaken, and gross capital employed rose by about $1.4 billion. Only in the past two years did earnings benefit significantly from this large commitment. Also, while dividends almost doubled over the nine-year period, the provision for payments to governments more than quadrupled. For 1974, governments will get $142 million directly from Noranda's operations, almost 3½ times the dividends received by shareholders. And in addition, they will get taxes from shareholders on the dividends. It is obvious that governments have obtained the lion's share of the benefits from the very large new investments made by Noranda in the past nine years, although it was the shareholders that took the risk.

As we attempted to show in the Annual Report, the realities of Noranda's situation in 1974 were considerably less satisfactory than the appearances. Inflation has made a mockery of financial statements prepared in the tradi-

tional way, and this is particularly true for capital intensive industries in circumstances where the cost of new construction and equipment has been escalating at a rate far beyond increases in the consumer price index.

Viewed simply, the depreciation provision in an earnings statement should be adequate to provide funds to replace worn-out or depleted assets. Profits are supposed to be available for payment to shareholders as dividends, or for investment in the growth of the company. A profit is only real if it could all be paid out as dividends to shareholders without impairing the long-term viability of the existing business. Noranda's reported profits in 1974 did not meet this test.

In today's environment, the problem is that assets are carried in financial statements at historical costs while earnings are stated in current dollars, and the two are simply not the same thing. Depreciation charges based on historical costs become completely inadequate to provide funds for needed replacements, with the result that earnings in real terms are substantially overstated and overtaxed. Another result is that capital employed is vastly understated in terms of current dollars, leading to the illusion that the rate of return from operations is much larger than it really is.

Looking behind the appearances, therefore, 1974 was not a great year for Noranda. Real earnings from operations were about half the stated level, and the true return on capital employed was about a quarter of what it seemed to be. It can be argued that this is offset by a large profit which accrues to shareholders from the decline in the value of the company's liabilities. However, it is thoroughly unhealthy to derive a substantial portion of real earnings at the expense of creditors.

While masked by apparent prosperity, the impact of inflation on industry's cost structure during 1974 was

pervasive and profound. At the same time, spurred by the illusion of great prosperity and the delusion that it would be permanent, governments imposed a bewildering array of new taxes on mining. The industry has been caught in a vice between conflicting taxing powers of the federal and provincial governments and, along with oil and gas, mining is now the most heavily taxed sector of the economy. The inevitable result will be stagnation and decline of the industry in Canada.

Thus, the events of 1974 will have consequences which will be debilitating in terms of the health of the resource industries — and in fact the entire Canadian economy — in the years ahead. Industries producing basic commodities always have been, and always will be, highly cyclical. The prosperity of 1973-74 has disappeared, but the higher cost and tax structures remain with us. The effect on our ability to justify new projects and to raise new capital for them will be serious. Nor will this problem be unique to the resource industries, which have always been the cornerstone of our economy.

The "Rip-Off" Of Investors

Of critical importance to Canada is the financing of the new investment needed to achieve our national objectives in the years ahead. By definition, such investment must come from savings. At the same time, the problems of inflation have intensified our debate over "income shares" — the proportion of national income accruing to labour, to governments, and to savers or investors. Conventional wisdom mistakenly suggests that profits — the returns to investors — have been unduly high over the past couple of years, and that simple justice requires that the other sectors catch up.

The fact that they have been doing so well will doubtless come as a surprise to most investors. The reality is that organized labour in this country has, so far,

generally been able to protect itself from the impact of inflation and that governments have profited from it. It is the weaker elements of society which have been hurt. Aside from those on fixed incomes, the major victims have been investors, who have suffered a devastating erosion in the value of their savings. If high inflation rates continue much longer, there is great danger that they will destroy our traditional capital markets.

The reasons for this are obvious — a higher rate of inflation requires a higher rate of return. An investor who receives a 10% rate of return on which he must pay taxes may be ahead of the game at 2% inflation, but will suffer a significant net loss with inflation at 12%. Under current conditions, industry is simply unable to achieve a gain in real profits to the extent needed to provide the required higher return, with the result that the value of securities has declined substantially. The problem is magnified by taxation of illusory earnings both in the hands of corporations and of their owners, the shareholders, and by public attitudes towards profits.

There seems to be a tendency to view corporations in a vacuum, and to assume that their profits are the immoral rewards of a few greedy robber barons. However, a corporation is only a mechanism through which the savings of large numbers of people are mobilized for the purpose of conducting a business. Profits are the legitimate and honest return on this investment, and attacks on these profits are really attacks on the savings of those who have risked them to provide capital for our economy. And inflation, vicious tax rates, limitations on profits and taxation of illusory earnings add up to an insidious "rip-off" of the country's savers and investors.

Of course, the present "rip-off" of investors appears to affect only a small portion of the population, but the fact is that the living standard and the quality of life of all Canadians depend on our capital markets. While they may

not realize it, most people have a significant stake in capital markets through their pension plans, insurance policies, mutual funds and so forth. They have an even bigger stake through creation of new jobs and sharing in the benefits of increased productivity, which can only come from savings and investment. And it is profits which provide both the incentive and the wherewithal for new investment.

In any event, the shattering of investor confidence has resulted in a situation where the market value of the shares of most industrial corporations has fallen to a fraction of the replacement value of the assets underlying them. And this occurred during a period of so-called prosperity. At current earnings multiples, common shares are generally providing an apparent rate of return far in excess of what industry could hope to earn on most new capital expenditure. Unless measures are taken to provide new and powerful incentives for saving and investment, the implications in terms of the private sector's ability to finance the new development needed in future are ominous.

The Problem Of New Projects

Even if capital were readily available and the rate of return required had not increased so sharply, industry faces serious problems in attempting to justify new projects. One of these problems relates to what has been happening to Canada's cost structure.

For some time, employee earnings in our resource industries have been the highest in the world. Recently, wage increases in Canada have been running at more than twice the rate of those in the United States, and our average wages in manufacturing now exceed those of our major competitor. Were this soundly based, it would be something from which all Canadians could derive great satisfaction. However, the harsh fact is that our productivity is still only 90% of that in the United States and,

in these circumstances, permanently higher incomes are an impossibility. While they persist, they are at the expense of our ability to compete.

What has happened is that, even in many sectors where we formerly enjoyed a comparative advantage, Canada has now become a marginal economy. Whether it be forest products in British Columbia, potash in Saskatchewan, manufacturing in Ontario or copper in Quebec, the level of our wages, expenses and taxes has made us high-cost producers in world terms. If no other remedy is found, this must ultimately lead to a serious devaluation of the Canadian Dollar if we are to remain solvent.

A second problem, which is not unique to Canada, is the incredible escalation in recent years in construction and equipment costs. New facilities in many cases today cost at least twice what they did three years ago and five times what they did ten years ago. Obviously, for capital intensive industries the level of product prices needed to provide even a nominal rate of return on such new facilities appears extremely high by historical standards. In fact, even the cyclically high average prices obtained for many products in 1974 were not enough to justify most new capacity at today's construction costs. This is true of pulp mills, new mines, copper smelters, aluminum reduction plants, and a wide variety of other facilities.

Obviously, prices must eventually rise to the levels needed to justify new capacity, ominous as this may be in terms of future inflation rates. One dilemma this will pose is that corporations will then appear to be earning enormous profits on assets installed in the past. While these profits will be illusory to a considerable extent, serious problems in terms of public and political perceptions are likely to result unless accounting methods are changed.

In terms of the Canadian mining industry, these problems have been exacerbated to the point of impossibility

when the new tax structures throughout much of the country are superimposed. Even if we were to revert tomorrow to the tax rates of the 1960's, confidence in the stability of the system has been shattered and cannot be quickly rebuilt. This means that a new risk has been added to the many others inherent in mining, increasing further the rate of return required to make new ventures feasible.

When added to the other problems, the result is that few new mining and related projects can now be undertaken in Canada unless they are government sponsored or artificially induced. It will simply not be possible to obtain a financial return commensurate with the risks involved. To take just one example, it is unlikely that any of the new mines opened in British Columbia over the past 15 years would be economically viable for development today under existing tax and cost structures, even at average 1974 prices. In these circumstances, further exploration becomes pointless, and the fact that it is still taking place even at sharply reduced levels can only be attributed to the industry's incurable optimism — or perhaps blind faith.

Thus, inflation has created great difficulty in terms of justifying most new projects and, when combined with tax changes, has resulted in a bleak situation for mining. One consequence will be serious shortages and even worse inflation during the next economic upturn. As a result, the Club of Rome's predictions regarding shortages of basic materials may come true, not because we have run out of resources but rather because it is impossible to mobilize the capital to find and develop them.

Current Conditions

In the meanwhile, shortages are certainly not a problem at the moment. Throughout most of the post-war period, markets for basic commodities followed different

cycles, and the wide diversity of the Noranda group provided a degree of stability. The unusual feature of the 1973-74 boom was its strength throughout the world, and the fact that it affected almost all commodities at the same time. Perhaps inevitably, the opposite is now the case, and markets for almost all of Noranda's major products have turned sour simultaneously. Moreover, for most products, market conditions during the first quarter of 1975 have been more severe than anything we have experienced since the 1930's.

Basic commodities are sold in international markets, and the concurrent weakness in virtually all major economies has resulted in a steep decline in end-user demand. Superimposed on this has been intensive inventory liquidation on the part of manufacturers, and a massive transfer of stocks from fabricators to primary producers. Thus, over the past several months, markets for the primary products of the Noranda group have collapsed abruptly, one by one. In many cases, producers have reacted by both accepting higher inventories and curtailing production and, because they have not attempted to force unwanted material on the markets, prices have held up reasonably well. In other cases, however, there has been significant price weakness.

Among mine products, copper has been affected in the most visible and spectacular way. After reaching an all-time high of $1.52 per pound on the London Metal Exchange a year ago, the price began to weaken during the second quarter, initiated by distress sales of surplus Japanese metal. The decline accelerated as weakness in demand developed elsewhere, and the LME price finally fell to a low of 53¢ in January of this year. North American producer prices, which reached 85¢ U.S. last June, were reduced in stages to the present level of around 63¢.

In response to the situation, the CIPEC countries announced a 10% reduction in copper exports in Decem-

ber and a further 5% this month. A number of U.S. producers have substantially reduced mine and metal production. In Japan, production has been reduced by 20% to 40% and shipments from supplying mines have generally been cut back by 15%. In Noranda's case, copper production was more than 20% below plan during the first quarter, reflecting reduced receipts of custom concentrate. Nevertheless, there was a substantial inventory build-up which, while it should ultimately prove to be a good investment, absorbed substantial quantities of cash.

There are signs that the worst of the inventory adjustment is over, but a dramatic surge in fabricator demand is not expected in the near term. Even when demand does improve, the very large producer and commodity exchange stocks must be absorbed before prices return to more reasonable levels. For this reason, we do not look for any significant strength in copper prices until 1977. In the meanwhile, recent price levels have been below the costs of many world producers, and are far short of the levels needed to justify new production.

The decline in demand for zinc was felt later than for copper — in December and January — but has been even more severe. With no prior surplus, producers initially were willing to build inventories but, as the weakness persisted, substantial production cuts began to occur. In Noranda's case, metal production was reduced to 75% of capacity in March, but is still well in excess of shipments. During the first quarter, only 55% of Valleyfield's production was sold, and a substantial inventory has been accumulated. Further production curtailments may prove necessary. The London Metal Exchange zinc price, which reached over 80¢ per pound last year, has since declined to a level moderately below the producer prices of around 38¢ per pound. However, there has been no significant weakness in the prices charged by producers to date, due to their willingness to curtail production and build inventories.

The aluminum situation is similar to that of zinc — demand has contracted sharply, producers have reacted by curtailing production and building inventory, and prices have remained reasonably stable to date. At Noranda Aluminum, there was a substantial build-up of inventory during the first quarter because it is difficult to cut production in a one-potline plant. In the case of lead, overseas prices have dropped about 40% from the high of 35¢ per pound last year to a level close to that quoted by North American producers. Production at the Brunswick smelter has been cut to 80% of last year's level and 50% of present capacity. Molybdenum demand has also softened, resulting in some increase in producer stocks. To date, fertilizer markets have remained strong and potash prices were increased during the first quarter. Unfortunately, under the new Saskatchewan tax system, the producer derives almost no benefit from such price increases.

In forest products, the lumber market was a disaster throughout much of 1974, with prices below the cost of production, and output was substantially curtailed. The timing of a revival in this market will depend on housing activity. Pulp demand, which remained strong throughout 1974, began to show signs of serious weakness during the first quarter of 1975. The market for paper began to weaken late in 1974, and Fraser Companies was forced to curtail production to about 70% of capacity during the past three months.

The situation in manufacturing is mixed. Demand for steel wire rope and some electrical wire and cable products has been reasonably well sustained. On the other hand, the markets for automotive and building wire, aluminum building products, plastic pipe and brass mill products have been poor, and output has been reduced to very low levels.

Noranda's Current Position

Thus, during the first quarter, Noranda was faced with both inflation and recession of a severity unique in the post war period. Unlike experience in past recessions, the impact was not diluted by Noranda's diversification as markets for nearly all products were seriously affected. In some cases, notably copper, this was accompanied by significantly lower prices. In most cases, circumstances required substantial production cutbacks, despite which sales of primary products fell far short of output. During the first quarter alone, Noranda's inventories of such products rose by some $40 million. At the same time, there was no moderation in the impact of inflation on operating costs, and the new tax systems were a burden throughout the quarter.

In the circumstances, it is disappointing but not surprising that earnings were severely affected. In the first quarter, net income of 78¢ per share was just about half of the $1.53 per share earned during the same period of 1974. The savage impact of the new tax systems is indicated by the fact that the overall rate was nearly 50% higher than in the first quarter of 1974. Despite the steep decline in earnings, the total provision for taxes actually increased. Copper mining, smelting and refining operations were hit the hardest, and accounted for more than half of the drop in profits. Aside from high taxes and low prices and sales, results were affected by reduced receipts of custom concentrates and by continuing production problems at Gaspe Copper.

The direction, if not the ultimate severity, of economic trends was anticipated in the course of Noranda's planning for 1975. It was expected that inflation would continue to place great pressure on the cost of needed replacements, and that cash flow from operations would decline sharply. It was forecast that conditions would likely require substantial inventory accumulations as well as

production cutbacks. At the same time, it was recognized that economic adversity presents opportunities as well as difficulties.

As a result, a policy of maintaining maximum financial flexibility was adopted. It was decided to curtail all expenditures where this would not damage the longer range future of the company. At the same time, if market conditions made it attractive, additional long term financing was planned to cover the cost of certain major projects already underway. The objective was to maintain a comfortable financial position together with a margin to permit Noranda to take advantage of any new opportunities that might arise.

In line with this policy, it was decided to reduce by about 100 million dollars, or 45%, the capital spending previously planned for 1975. With two major exceptions, the curtailments were in projects which had been planned but not yet started. In the light of the impact of inflation and new tax measures on the economic viability of new investment, many of these projects will be permanently cancelled, but where a reasonable rate of return can still be obtained they have merely been deferred. Other expenditures have also been curtailed, but programs of major long term importance have not been affected. In particular, research and exploration expenditures in 1975 are expected to increase, although the emphasis in the latter area continues to shift.

For the reasons outlined earlier in these remarks, a substantial portion of the earnings currently being reported is illusory due to the underprovision of depreciation. As a result, Noranda's real earnings from operations during the first quarter were negligible. In spite of this, at their meeting this morning your Directors declared the same dividend as during the previous two quarters — 50¢ per share payable June 16th to shareholders of record May 9th. This is considerably in excess of real income

and, in the light of the policy of restraint in other areas, continuation of the dividend at the previous rate may seem surprising. Nevertheless, we believe it to be justified.

Noranda's policy is to attempt to avoid wide fluctuations in dividend payments, provided that this does not impair the company's financial strength. In particular, we are conscious of the fact that shareholders have been the real victims of inflation and deserve special consideration. In 1974, the dividend was only 27% of reported earnings, although a considerably higher portion of real income. Thus, a relatively high payout can be justified temporarily, particularly since we believe that we are now going through the worst of the recession in terms of its impact on Noranda's earnings.

Outlook

Our best guess at the moment is that, while final demand may recover slowly, the inventory adjustments should have run their course in a number of products by the end of the second quarter. We therefore expect an improvement in shipments during the second half of the year, although the timing will vary from product to product. This will not likely result in significantly higher prices, but should permit an improvement in Noranda's volume and earnings over the levels now being experienced.

Looking further ahead, even last year's prices for most primary products were inadequate to justify new capacity. Because added production will not be available otherwise, substantially higher prices are inevitable in the absence of complete economic collapse. Thus we continue to view the future of our major businesses with considerable optimism from a commercial standpoint. The uncertainty is how the resulting earnings will be divided between governments and shareholders.

A major danger in the outlook is that inflation will ultimately tear apart the fabric of our society, and all Canadians should be prepared to make sacrifices to help bring it under control. For this reason, Noranda is willing to cooperate with the recently-announced effort of the federal government to achieve consensus on voluntary restraint of prices and incomes. This willingness assumes that the program is practical, is applied fairly to all sectors of the economy, and does not exacerbate the situation by placing even more obstacles in the way of new investment. However, this effort must be viewed with considerable skepticism. Controls under whatever guise have consistently failed when tried, because they attack only the symptoms rather than the underlying causes of inflation.

We should never forget that governments create inflation, and that the rest of society merely reacts to it. Governments at all levels have been the fastest-growing sector of our economy, having increased their revenues from 38% of GNP in 1966 to nearly 50% last year. Their excessive demands on the system are the fundamental cause of inflation. In the absence of determined and drastic self-restraint on the part of the public sector, no effort to slow down inflation will have a chance of real success. But evidence of any such self-restraint is difficult to find.

Aside from the problems dealt with at length in these remarks, there are a great many reasons for concern regarding the economic and political environment throughout the world. These include an unstable international financial situation, economic nationalism and increasing government involvement in all aspects of business decision-making — often on the basis of short term political expediency without regard for the ultimate economic consequences. Throughout the world, private investment is under attack and profits are in disrepute. In this sort of environment, it will be difficult for the private sector to

mobilize the capital and expertise needed, and unrealistic to expect that governments can fill the void. As a result, economic progress is bound to lag far behind potential and, while this may be welcomed by "no-growth" advocates, there will be a considerable cost in terms of human misery.

For Noranda, circumstances require some changes in direction. While maintaining a strong position in manufacturing and forest products, mining and metallurgical activities will not be neglected. However, as viable new projects will be difficult to find in Canada, a more international approach will be required. Despite present problems, Noranda has a sound operating base, a good financial position and great strength in terms of its people. We intend to maintain our flexibility, remain alert to new opportunities, and wait for better days.

PRINTED IN CANADA

REPORT OF THE ANNUAL MEETING

April 26, 1974

noranda

ANNUAL MEETING REPORT

This brief report has been prepared for the benefit of shareholders who were unable to attend the Annual Meeting.

The meeting was convened at 2:30 p.m. at the Royal York Hotel, Toronto, with about 600 in attendance. Alfred Powis, President of the Company, acted as Chairman. There were 16,560,143 shares, or 68.02% of the total shares outstanding, represented either in person or by proxy.

The Annual Report, including the Auditor's Report, was submitted to the meeting.

The following shareholders, who were present, were elected directors of the Company: James C. Dudley, Louis Hebert, William James, Leonard G. Lumbers, David E. Mitchell, Andre Monast, Richard V. Porritt, Alfred Powis, William S. Row, John D. Simpson, William P. Wilder and Adam H. Zimmerman.

Tribute was paid to John R. Bradfield, Chairman of the Board, who has retired from the Company after 48 years of outstanding service. A Director of the Company since 1951, Mr. Bradfield did not stand for re-election, and Mr. Adam H. Zimmerman was welcomed as a new member of the Board.

Clarkson, Gordon & Co., Chartered Accountants, were re-appointed auditors.

By-Law No. 1, relating generally to the transaction of the business and affairs of the Corporation was confirmed 16,412,202 to 9,568.

By-Law No. 2, respecting the borrowing of money and the issue of securities was confirmed 16,408,088 to 13,682.

By-Law No. 3 relating generally to the remuneration of the directors was confirmed 16,384,098 to 37,672.

Following completion of the formalities of the Meeting, questions were invited from the floor and were answered as follows:

In response to a question as to whether Noranda had ever considered appointing a woman director, Mr. Powis answered that the corporation attempted to gather together the best expertise from outside the corporation to bring to bear on the specific problems faced. As yet the Company had not come

upon someone whose expertise in the natural resource field was such that it made her an obvious choice for the Board.

A shareholder wished to know the impact of the new Ontario tax rates on the recently announced Noranda Metal Industries plant to be constructed at Arnprior for the production of nuclear tube. Mr. Powis answered that tax changes mentioned in the Ontario budget were applicable to mining and metallurgical operations and would have no effect on the new Arnprior manufacturing plant.

A shareholder asked if Noranda had considered adding international experts to the Board as the company's operations expanded abroad. Mr. Powis stated that while Noranda could not be considered a multinational corporation, if international operations continued to grow, such a move might be considered. He noted that when Noranda expanded in the United States, the Company had invited Mr. Dudley, of New York, on the Board.

A shareholder suggested that the Company might consider shutting down some of its operations as a protest against high taxes or union action. Mr. Powis stated such a unilateral action would be irresponsible and create great hardship for employees and shareowners who were not to blame.

In response to a shareowner who wished to know what effect new tax rates in B.C. and Ontario would have on earnings, Mr. Powis stated that earnings for the first quarter reflected the new rates in British Columbia. Estimated impact of Ontario taxes would have been $1,300,000 for the quarter, mainly affecting revenues from the Geco Division mine in northwestern Ontario.

ADDRESS OF THE PRESIDENT TO THE SHAREHOLDERS AT THE ANNUAL MEETING

Ladies and Gentlemen:

Last year was an extraordinary one for industry in general, but particularly for producers of commodities. During the previous three years, commodities generally had been in surplus supply and producers were squeezed between continually rising costs on the one hand and lower volume and prices on the other. Profits were low and new production facilities were difficult to justify. As a result, an unexpectedly strong level of industrial activity throughout the world in 1973 quickly overtook capacity to produce many raw materials, resulting in shortages and substantially increased prices. There is nothing new in this, of course, since industries producing basic commodities have always been very cyclical. What was unusual about 1973 was the strength of the economic rebound and the fact that it affected almost all commodities at the same time.

1973 RESULTS

As a result, 1973 was a year of strong demand and higher prices for virtually all of the products of the Noranda Group, and earnings rose 75% to a record $121 million, or $5.17 per share. All major divisions contributed to this increase, with earnings from forest products up 40%, from mining and metallurgical operations over 60%, and from manufacturing more than 100%.

These results must be viewed with some caution since, due to the buoyant trend of prices throughout the year, they include an element of inventory gain which is non-recurring. Moreover, as it happened, the inclusion of Noranda's equity in the undistributed earnings of corporations less than 50% owned had a significant impact on comparative results, although these earnings are only available to Noranda to the extent of dividends paid. Finally, there was a benefit from the reduced tax rates applicable to manufacturing and processing.

On the other hand the 75% increase in earnings, large as it may seem, was considerably less than should have been achieved under last year's economic conditions. The late and

difficult start-up of Gaspe Copper's expanded production facilities, the two month strike at the Geco Division, and the rail slowdowns and strikes resulted in copper production being considerably less than planned. To ensure that the requirements of Canadian manufacturers were met, this shortfall in production required that all of Noranda's own copper metal be sold in the domestic market, where prices were maintained at levels substantially lower than those outside North America. In addition, the liquidation of Fundy Forest Industries caused an after-tax loss of $2.7 million. Had these problems not occurred, 1973 earnings would have been more than double those of 1972, and we can therefore take little pride in the actual results.

PERSPECTIVE ON EARNINGS

Nevertheless, a 75% increase in earnings is substantial, as were those recorded by many other companies across a broad spectrum of Canadian industry. Because of the present political controversy about profits, particularly as regards the resource industries, it seems appropriate to analyze Noranda's 1973 results in greater detail than usual, in an attempt to place them in perspective.

To do this, it is useful to go back to the beginning of 1967, when Noranda had virtually no debt and had gross capital employed of nearly $500 million. Seven years later, at the end of 1973, gross capital employed was close to $1.5 billion, an increase of 200%. This increase was financed roughly a third by issue of long term debt, about 55% by retained cash flow from operations and by common share issues, and the balance largely by short term borrowings.

However, from 1966 through 1972 Noranda's earnings were relatively flat, increasing by only 21% over the period. It is only when 1973 is added that the record begins to look respectable — an increase since 1966 of 121% — but even this falls far behind the increase in assets employed of nearly 200%. Of course there are reasons, or at least excuses, for this. The impact of large new investments during the late 1960's was slow to make itself felt on results, which is not uncommon, and the early 1970's was a depressed period in most sectors in which we operate. As a result, from 1967 through 1972 Noranda's rate of return on capital employed was declining, and only partially recovered in 1973.

In this connection, there is a great deal of talk about the so-called economic rent earned by the mining industry, which

apparently means an excessive rate of return on capital employed. An excessive return has been defined rather arbitrarily by one of the leading critics of the industry as anything more than 15%. Unfortunately, by this definition Noranda has not earned an economic rent. There are many methods of calculating rates of return, a common one being earnings plus interest as a percentage of net worth and long term liabilities. On this basis, Noranda's rate of return of 16% in 1966 declined to 9% in 1972 and recovered only to 14% in 1973. However, we are unable to find any other major Canadian mining company which earned a so-called economic rent over this period either.

Another important factor is the impact of inflation. After a period of trying to cure it, we now seem to be resigned to the probability that it is a permanent problem. Evidence of this is the indexing of the personal income tax structure and the Economic Council's abandonment of absolute targets in favour of merely attempting to keep our rate of price increase below the average of our major trading partners, whatever it might be.

In any event, the impact of inflation is such that it is appropriate to ask whether traditional calculations of return on capital employed are any longer meaningful. This is particularly true because the cost of new construction has been escalating at a rate far beyond that of the consumer price index or the GNP price deflator. To cite two examples, the first stage of the Canadian Electrolytic Zinc plant, completed in 1963 at a cost of $16 million, would probably cost more than $80 million to duplicate today. The Gibraltar mine, placed in production in 1972 at a cost of $63 million would probably cost more than $110 million were construction started now.

Thus, it is clear that in terms of replacement values Noranda's assets are vastly understated on its balance sheet. They are carried at historical costs, while earnings are stated in current dollars. Ratios derived from our statements would make sense if the real value of the dollar were relatively stable, but become nonsense in a period of high inflation. The dollars at which the assets are carried are simply not the same as the dollars being earned. To illustrate, we estimate that Noranda's fixed assets in 1973 dollars are at least double their stated value on the balance sheet. If our accounts were adjusted to reflect this, Noranda's rate of return in 1973, rather than the 14% derived from published statements, would be only 5% in real terms.

Inflation obviously creates many problems and this is only one of them. However, it is highly relevant to the creation of new capacity, which is the only answer to the problem of eliminating shortages. A corporation or industry may appear to be earning a lucrative rate of return on assets carried at historical values, but the level of prices for its products may still be inadequate to justify new capacity at present highly inflated construction costs. Clearly, if we are to live with rates of inflation very much in excess of those we have been accustomed to, new accounting methods must be adopted to avoid misleading not only our shareholders and employees but also the public at large.

Another misconception which seems to have gained credence is that the current shortages of raw materials are permanent, and that we will henceforth be able to sell all we can produce at ever higher prices. Over and over we hear it said that our resources are becoming scarcer and of greater value. Perhaps this is true of petroleum products, but if so it is for reasons having no application to most commodities. It would be nice if the highly cyclical nature of the mining industry has suddenly been altered, but it simply hasn't been unless we have reached a millenium in which business cycles themselves have been eliminated. To take just one example, there are enormous known deposits of copper throughout the world awaiting development, and there will be no permanent shortage. We have been through many cycles of shortage and surplus in copper in the past, and we will again. Of course, the levels around which copper prices fluctuate will increase, but this dos not reflect an increase in real value but rather the impact of inflation.

One function of management is to make money for its shareholders, and quite frankly it goes against the grain to admit that, despite a 75% increase in earnings, our performance is not nearly as good as it seems. After making similar statements a few months ago, we were accused by a prominent critic of "crying all the way to the bank". Nevertheless, despite the politically-motivated unwillingness of many people to rearrange their prejudices, the facts are clear. What happened in 1973 was a sharp recovery from a cyclical low point, and the cyclical nature of commodity markets has not disappeared. The recovery in earnings reflected, in part, substantial new investment made over the past seven years, much of which made little real impact on earnings until 1973. Moreover, our return on assets employed has still not returned to the levels prevailing in the mid 1960's, and in any event has become meaningless due to the effect of inflation.

BUSINESS CLIMATE

Noranda's circumstances in 1973 were broadly duplicated throughout Canadian industry. And yet, we are being subjected to a constant barrage of political propaganda regarding enormous increases in corporate profits, characterized as a "rip-off" which is the major cause of rising consumer prices. It is tempting to adopt a cynical attitude towards such rhetoric, since generally the sources are much too sophisticated to really believe what they are saying. However, it would be dangerous to ignore the fact that the rhetoric is being believed by a substantial number of Canadians.

The seeds of today's problem of shortages were sown during the 1967 to 1972 period, when Canadian industry was plagued by a combination of low profits and a high degree of uncertainty. Tax reform and other proposed legislation damaging to industry, combined with the debate over foreign ownership policies and upheavals in international currency and trade relationships, would have been daunting enough in a period of prosperity. When coupled with the low level of profits, the result was an unusually small rate of growth in new capital investment, which has caused today's shortages.

To the extent that shortages are contributing to the problem of inflation, it is obvious that heavily increased capital investment is the only solution. It is also obvious that this investment will not be made unless industry has the ability to finance it and there is the prospect of a reasonable rate of return. Moreover, by increasing the cost of new capital, inflation also increases the rate of return needed on new investment. Where profits are held back, new investment will not occur. Where they are adequate, production will be expanded and shortages will be relieved. This means that a good level of profits is actually essential to help control inflation, and that the current attacks on profits are really directed at the cure and not the disease. And yet we are now beset by proposals for all manner of tinkering with the market system such as wage and price controls, excess profits taxes, rate of return limitations, dividend ceilings and so forth. Left to itself, the market system will in time solve the problems, while political interference will merely perpetuate them.

As far as the Canadian mining industry is concerned, the situation is discouraging despite the current image of prosperity. At the root of the problem is the repeated assertion, which cannot be supported by sound analysis, that the industry earns excessive profits from the extraction of non-renewable resources belonging to the people and that an inadequate

proportion of these profits are returned to the people in the form of taxes. The result has been a reversal of past Canadian policies, which worked so well, of incentives for the exploration and development of our resources. The federal tax reform legislation, which eliminated most of these incentives in the name of so-called equity, was bad enough. But now the industry is being looked upon by certain provinces as a source of revenues to be squeezed dry regardless of the long term consequences. The savage new Ontario graduated taxes mean that Noranda would pay a rate of over 60% on profits from new mine development in this province, compared with around 40% in the case of manufacturing and processing industries. Manitoba has also proposed steep new taxes on mining.

Even more devastating, however, is the impact of royalty legislation such as that proposed for British Columbia. This legislation not only imposes a gross royalty on mine production but also imposes a "super royalty" on price increases. Making the assumption that inflation will be a relatively permanent problem and that business cycles have not been eliminated, this legislation would make it impossible for the private sector to earn a reasonable return on most new mine development. If new mines are not worth developing, then there is no point in exploration and the enormous remaining potential of the province will remain largely undiscovered. Legislation of this nature will ensure that the people, who supposedly own the resources, will derive minimum long term benefit from them, although the short term financial rewards may appear promising. It will destroy the people's resources by ensuring that further orebodies will remain undiscovered and that the lower grade tonnages in existing orebodies are converted to waste rock.

The mining industry has a number of other serious problems such as the drastic escalation in construction costs, labour shortages, unstable international trade and currency relationships, uncertain future prices and so forth. We can cope with these problems, but when an unstable political climate is superimposed the result becomes oppressive. The level of exploration for new mines in Canada has declined significantly in recent years and has not recovered in line with the industry's increased profitability. Inevitably this has led to a decline in the number of new discoveries and in new mine development. In 1974, new investment by the mining industry in Canada will continue the declining trend of the past few years, unlike almost all other sectors of the economy. What therefore appears inevitable over the next few years is stagnation of the Canadian mining industry, a level of growth very

much less than it could be. This is bound to persist at least until rapacious tax rates are modified and public policy towards the industry becomes stabilized so that new investment can again be undertaken with some assurance as to what the rules will be.

Some argue that stagnation in mining would be desirable, as capital would then flow in increasing amounts to other industries where more employment would be created per unit of investment. The fact that this is nonsense has been dealt with at length in previous remarks to Noranda shareholders. If mining is to be deliberately discouraged, it is improbable that anything of comparable value to Canada in terms of international competitiveness and contribution to regional development, employment and living standards can be created to take its place.

MARKETS

Turning to more immediate matters, as previously noted the prices of most of the products of the Noranda Group rose significantly, and in some cases spectacularly, in 1973. However, in most cases these price increases started from cyclically depressed levels, and their extent has been distorted by changes in the relative values of currencies. In fact, due to the impact of inflation, year end Canadian prices were probably not high enough to provide a reasonable return on new capacity. In spite of this, three months ago the 1974 outlook for mine products appeared obscure and ominous due to the prospect of a sharp recession induced by energy shortages, but to date this year markets for most of our products have remained surprisingly strong.

Copper is the most dramatic example. The year-end price level in markets outside North America of 91¢ per pound was above the level needed to encourage new supplies. Moreover, the real gap between demand and production was not large, and there was reason to expect that reduced economic activity would produce a surplus in 1974. While this may still happen, it certainly hasn't to date, and the LME price reached an incredible high of $1.52 U.S. per pound on April 1. It has since declined but is still at an unsustainable level. Barring strikes which could occur in the U.S. industry this summer, it would not be surprising to see the LME price drop substantially later this year. On the other hand, the present Canadian domestic price which was increased to 77½¢ per pound in March is probably still inadequate to justify much new production in this country in view of changes in our cost and tax structures.

It should be repeated again that Noranda derives little direct benefit from high overseas prices, since most of its own production is sold in Canada.

The zinc market has been considerably more orderly. World producer prices increased in stages by some 14¢ U.S. per pound in 1973 and have risen a further 4¢ to 36¢ this year. However, these changes reflect to a significant extent the decline in the relative value of North American currencies. Moreover, the price of zinc has been unduly low for many years, resulting in the present shortages, and prices around current levels are needed to justify increased production.

Gold and silver prices have, of course, risen spectacularly as confidence in paper currencies has been eroded. Here again, however, prices had long been at levels which precluded new production, with mounting industrial demand being met increasingly from accumulated inventories. When enormous speculative demand was superimposed on normal requirements, prices inevitably soared.

The situation with respect to other products is very much the same. Demand for molybdenum, following three bad years, picked up sharply in 1973 and the industry's excessive inventories were gradually reduced to normal working levels. Supplies are now tight. After several depressed years during which new facilities were difficult to justify, aluminum demand has caught up to capacity and prices have risen some 50% in North America and more elsewhere. Nevertheless, present North American prices are probably still inadequate to justify substantial additions to existing capacity.

While potash supplies are also extremely tight, the problem here is not lack of capacity to produce. Saskatchewan took upon itself the entire burden of world excess capacity through its prorationing system, and allowables for the current fertilizer year were established at 58% of installed capacity despite representations that this would clearly be inadequate. When this proved to be the case, allowables were increased substantially, but production cannot simply be turned on and off like a tap. As a result, farmers are not getting all the potash they need, and the Canadian industry is losing a substantial volume of business. Clearly, the time has come to abandon artificial restraints on production permanently.

In forest products, trends are mixed. Pulp and newsprint are in short supply, again reflecting several years of low investment in new facilities due to surpluses and depressed prices.

On the other hand, there is ample capacity to meet the demand for lumber, particularly with the present weakness in housing starts. Recent gyrations in prices seem to reflect a shortage of rail cars to move lumber to the market.

Thus, with the notable exception of mines selling copper overseas, present price levels for most products of the Noranda Group are not excessive in relation to what is needed to encourage new production. It is also worth repeating that Canadian domestic prices for base metals have been held by producers at levels substantially below those prevailing elsewhere. Copper is the most extreme example, with the LME price reaching a level almost twice that in Canada this month, but domestic prices of other metals such as lead and zinc are also being maintained at levels less than those prevailing elsewhere.

CURRENT DEVELOPMENTS

A recent study of the Canadian economy by the C. D. Howe Research Institute observed that "no matter where one looks, the conditions and assumptions that were so familiar in the post-war era have come apart, leaving a future that is unpredictable and confusing. In short, the comfortable status quo established in the early 1950's has disappeared, and it has yet to be replaced by a new set of familiar, and hence predictable, relationships. We are sailing into uncharted waters." The study goes on to point out that, while economic conditions have always been subject to change, the breadth and depth of the current changes in international institutions and relationships, and in fundamental attitudes towards growth, work and national goals are such that this period is one of profound historical significance. It asks "whether Canadians and the world in general can adapt to the disappearance of the status quo or whether their actions will become defensive, leading to inaction and, eventually, chaos."

Certainly the rules of the game are changing so quickly that the temptation to sit on the sidelines until the situation is clarified seems at times overwhelming. Leaving aside all other problems, the possibility that the only cure for spiralling inflation may be an economic and financial collapse is frightening. However, Noranda's fundamental objective is to use its capital and the skills and abilities of its people constructively for society, which must involve providing a satisfactory and growing return on its shareholders' investment. Of course, with high inflation, apparent growth in earnings and underlying share values becomes illusory. For example, if we are to

average 10% inflation, then Noranda's earnings and the value of its shares must at least double every seven years merely to keep shareholders' capital intact. In these circumstances, providing genuine growth in the return on shareholders' investment becomes a real challenge.

Despite the dangers in the present situation, therefore, we believe that the best interests of Noranda shareholders will be served by a continued search for new opportunities in the fields in which we have expertise. Accordingly, we will continue to increase our exploration and research efforts and to vigourously pursue new developments where the opportunity for a reasonable rate of return seems to exist. While this restricts new ventures in a number of areas, including large parts of Canada, we believe there will be no lack of opportunities.

In the area of research, the Noranda Continuous Smelting Process represents a significant breakthrough in the field of copper metallurgy. On the basis of the technological superiority of the process, Noranda has been awarded the right to build a smelter and refinery to produce 100,000 tons of copper per year in the Republic of Korea, in equal partnership with a group of local companies. A final decision to proceed must await the results of a detailed feasibility study which is now underway. Kennecott Copper has recently announced plans for modifying its Garfield smelter, one of the world's largest, which include the use of several Noranda reactor units under a licensing agreement. The possible use of the process is also under study by several other copper producers.

Reference was made in the Annual Report to an agreement under which Noranda would arrange for interim financing for Tara Exploration and Development pending issue of the mining lease on its important zinc-lead deposit in Ireland. If feasible, Noranda and the Tara group would also construct a jointly-owned electrolytic zinc reduction plant in Ireland. At the same time, at the invitation of the management, Noranda began to accumulate Tara shares on the open market. When a tender offer for control by third parties was made in mid February, this accumulation was accelerated in support of Tara's Irish management, and Noranda now owns about 20% of the company's outstanding shares. When combined with the holdings of other shareholders supporting the Irish management, this represents more than half of the outstanding shares.

This month, Noranda acquired a 51% interest in Fraser Companies Limited at a cost of some $35 million. Fraser, which

is a substantial producer of lumber and pulp in New Brunswick and of paper in Maine, will provide further integration and regional balance to the forest products interests of Noranda, hitherto concentrated entirely in British Columbia.

As indicated in the Annual Report, a number of other important projects are underway including a further major expansion and pollution control program at the Horne smelter, expansion of the Valleyfield zinc plant, increased mine production at Brunswick and a nuclear tube plant to be built by Noranda Metal Industries. Consideration is also being given to a doubling of the Noranda Aluminum reduction plant at New Madrid. In total, capital expenditures and investments should be at a new record level in 1974, and to assist in financing this a $50 million debenture issue was sold privately this month.

OUTLOOK

In terms of current operations there are a number of problems. Costs in all areas continue to rise at rapid and alarming rates. Rail car shortages continue to plague operations throughout Canada with a particularly disrupting effect on forest products operations. Until the new B.C. royalty legislation is clarified, we can only guess at results from mining operations in that province, but the guesses reflected in first quarter results constitute a very substantial impact. Noranda Aluminum has been affected by a strike which began on February 1 and still continues, while inflationary pressures are causing sporadic labour difficulties at a number of other operations. Finally, while we had thought that the start-up problems at Gaspe Copper had been largely overcome, this proved to be somewhat optimistic and, while improved, operations are not yet satisfactory.

However, as indicated previously, demand and prices for most of our products have remained surprisingly strong, and earnings for the first quarter of 1974 were $1.53 per share compared with a restated 92¢ during the same period of 1973. While this is a 67% increase it is less than was earned during the fourth quarter of last year. Compared with last year's first quarter, earnings from mining and metallurgical operations rose 71% while manufacturing earnings increased 132%. On the other hand, earnings from forest products were off 54%, the most significant factors being rail car shortages and high stumpage charges. At their meeting this morning, your Directors declared a dividend of 45¢ per share payable June 14 to shareholders of record May 10.

The outlook for the balance of the year remains obscure. Inflation will continue to place a strain on labour relations, rail car shortages seem unlikely to be solved in the short run, costs will continue to mount and economic trends are anybody's guess. In addition, new taxes will have a substantial impact on results from mining operations in Ontario and B.C. Nevertheless, if our expectation for improved copper production over the balance of the year is realized, and if there are no serious interruptions to production, 1974 results should be better than those of 1973.

The longer term outlook is even more obscure and also contains elements of real danger, not only for corporations such as Noranda but also for the entire economic and social structure which, for all its faults, has served Canada so well to date. This, of course, will present management with problems of unprecedented proportions. In this context, I can only repeat my statement of last year that I believe we have an extraordinarily talented and effective group of employees, with the ability and flexibility to adapt to whatever changes in direction and emphasis may prove necessary.

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